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SUBJECT: (C) LUKOIL TELLS AMBASSADOR SATTERFIELD IRAQ CAN'T
MODERNIZE WITHOUT PRODUCTION SHARING AGREEMENTS

Classified By: Ambassador William J. Burns for Reasons 1.4 (b/d)

SUMMARY

¶1. (S) Lukoil president Vagit Alekperov told Ambassador Satterfield April 2nd that production sharing agreements (PSAs) are a prerequisite to multi-billion investments needed to modernize Iraq's oil infrastructure and develop fields. Alekperov indicated that Lukoil may still be willing to work in Iraq under less-preferable service contracts, but would invest less. He said that Oil Minister Shahrستاني is the impediment to adoption of the PSA model in pending hydrocarbon legislation, adding that Shahrستاني "spent too much time in Iran." At Ambassador Satterfield's suggestion, Alekperov said he would reiterate his views on the need for PSAs to Prime Minister Maliki, emphasizing the benefits to Basra's economic development. Alekperov welcomed continued dialogue with us on Iraq and said his staff in Iraq will reach out to our Embassy in Baghdad. End summary.

LUKOIL READY TO INVEST

¶2. (C) In an April 2 meeting with Coordinator for Iraq (S/I) Ambassador David Satterfield, Lukoil president Vagit Alekperov said Lukoil is eager to move forward with potential investments in Iraq. He said Lukoil is closely coordinating its efforts with ConocoPhillips, which owns 20% of Lukoil. Ambassador Satterfield responded that we welcomed Lukoil's involvement in Iraq and its engagement with the GOI.

¶3. (C) Alekperov said the sooner major investments in oil can proceed, the sooner Iraq will develop its physical and social infrastructure and stabilize. Referring to Lukoil's own interest, the West Qurna 2 field, Alekperov explained that Lukoil's investment in creating the supporting infrastructure alone would create some 7,000 jobs, "drastically improving the economic situation in the South." He said West Qurna 2 would produce some 400,000 barrels per day when developed, with all production to be exported.

¶4. (C) Alekperov said all his interlocutors during his recent trip were positively disposed to Lukoil proceeding with "direct negotiations" in Iraq with the exception of Oil

Minister Shahrستاني. He said Shahrستاني "seemed nervous" during their meeting and simply said "everything needs to go through a tender, according to the hydrocarbon law." Alekperov noted to us, however, that there is no hydrocarbon law but that existing legislation allows for direct negotiations "as approved by (assistant to the Prime Minister) Ghadban." He called Ghadban "a real professional -- professional with a capital 'P'."

THE NEED FOR PSAS

¶5. (C) Ambassador Satterfield noted that it was not just Shahrستاني that was the problem; many in the Oil Ministry shared the same "dirigiste" mindset. He said we were pushing the Iraqis in the direction of production sharing agreements (PSAs) rather than service contracts and private sector development of the oil sector instead of state-driven development. He stressed the importance of that message being reinforced by private companies like Lukoil.

¶6. (C) Alekperov agreed that transformative investments would not occur without an appropriate hydrocarbon legal framework, including PSAs. Lukoil, he said, would not spend the billions of dollars necessary to modernize Iraq's oil and ancillary physical and social infrastructure without the "insurance and guarantees" offered by PSAs. "Service contracts just don't offer the returns we need." That said, Alekperov suggested Lukoil and ConocoPhillips could still operate in Iraq under service contracts.

¶7. (S) Alekperov said Shahrستاني is the impediment to

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inclusion of the PSA model in pending hydrocarbon legislation. He said "Shahrستاني has spent too much time in Iran" and is fixated on the Iranian model. He said "Shahrستاني will never agree to PSAs" and that this is "a big problem." He agreed that perhaps the Oil Ministry in general is too "statist" in its approach, but added that, according to a Russian saying, "a fish rots from the head down."

TATARSTAN = KURDISTAN

¶8. (C) Ambassador Satterfield said a major problem was the inability of the Kurds and the central government to agree on how to develop Iraq's oil resources. Alekperov agreed, likening the situation in Iraq, with regional desires for autonomy, to the situation in Russia during the 90s, when the oil-rich Tatarstan and Bashkortan regions wanted control over their hydrocarbon resources. He said the resolution in Russia of allowing some autonomy to spur development of those regions while spreading the wealth through central taxation was largely successful -- "Everyone got bread; Tatarstan and Bashkortan got bread and butter."

RUSSIAN DEBT FORGIVENESS

¶9. (C) Alekperov said the government of Russia is eager to see movement on Lukoil and Russian oil interests in Iraq. He said that the GOR must be able to show the public that writing off some \$12 billion of Iraqi debt will yield some result for Russian companies.

LUKOIL WILL CONTINUE DIALOGUE WITH US

¶10. (C) Ambassador Satterfield suggested that Alekperov reiterate to Prime Minister Maliki the importance of PSAs to

economic development and employment generation, especially in Basra. Alekperov said he would pass on his views through his staff to Maliki's staff and that he expects to meet with Maliki again in May.

¶11. (C) Alekperov also agreed to meet with U/S Jeffery in the future and asked to meet with Ambassador Satterfield when he is next in Washington. He said he would be there soon to meet with ConocoPhillips CEO James Mulva. Responding to Ambassador Satterfield's suggestion that Lukoil keep us updated on their progress in Iraq, Alekperov said Lukoil staff in Baghdad would reach out to our Embassy there.

¶12. (U) This message has been cleared with Ambassador Satterfield.
BURNS